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In the Supreme Court of the United States

OCTOBER TERM, 1936

No. 703

OLD COLONY TRUST COMPANY, TRUSTEE, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 51–60) is reported at 33 B. T. A. 311. The opinion of the Circuit Court of Appeals (R. 77–84) is reported at 87 F. (2d) 131.

JURISDICTION

The judgment of the Circuit Court of Appeals for the First Circuit was entered December 10, 1936 (R. 84). The petition for writ of certiorari was filed February 4, 1937, and was granted March

15, 1937 (R. 85). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the petitioner, in computing its taxable net income as trustee for ~~the~~ year 1931, is entitled to deduct from its gross income certain amounts paid during the year to exempt religious, charitable, or educational corporations.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 28–31.

STATEMENT

The facts were stipulated before the Board of Tax Appeals (R. 18–50):

Henry Clay Jackson, of Boston, Massachusetts, died intestate, leaving Paul Wilde Jackson, a brother, as his sole heir (R. 24). Paul Wilde Jackson, apparently to carry out certain wishes of his brother, executed a deed of trust under date of July 19, 1922 (R. 24–31), whereby he conveyed to the petitioner, as trustee, all of his right, title, and interest in and to the property of Henry Clay Jackson remaining after payment of debts and other charges against the estate (R. 24).

The deed of trust, after providing for present distribution of a part of the property transferred and for the payment of stated annuities to a num-

ber of individuals, some of whom were still living during the taxable year involved, contained the further provision (R. 29):

> 13. I authorize my said trustees to pay to charities as hereinafter described such sums as in their judgment may be paid without jeopardizing the annuities herein provided for, whenever for a period of one year the trust fund held by them as then invested shall have yielded a net income equal to twice the amount of the annuities which they are then required to pay, and upon the death of the survivor of those persons, who under the terms of this instrument are to receive annual incomes under the trust hereby created, I direct my said trustees to distribute the rest and residue remaining in their hands among corporations and trustees organized, operating and holding exclusively for religious, charitable, scientific, literary or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, the sum paid over by said trustees to such corporations or boards of trustees to be held by such corporations and boards of trustees in trust, and the income thereof to be expended for the general purposes for which such corporations and boards of trustees are organized, and I request that said funds be designated by each corporation or board of trustees as the Henry Clay Jackson Fund.

The first property received by the petitioner under the deed of trust was received on May 29, 1923

(R. 20). The total value of property received under the trust deed is not shown, but it was apparently quite substantial (cf. R. 22). Upon receipt of the first trust principal by the petitioner, separate accounts were opened for principal and for income (exclusive of gains from sales of corpus, which were carried in the principal account). The principal account has always been maintained separate and apart from the income account, and no annuity payments or payments to charities have been charged to the principal account (R. 20). The amounts which the petitioner in its judgment considered available each year for payment to charities without "jeopardizing the annuities", the amounts appropriated to charities each year, and the years in which payments were made, were stipulated (R. 21).

The income account of the trust disclosed an unexpended balance at January 1, 1931, the beginning of the taxable year involved, of $187,999.43 (R. 34, 54). During the year 1931, the trust received net income of $164,339.39 (R. 19, 34–35, 54). Of this amount, $61,481.32 represented gains from sales of corpus which were added to the capital account and the balance of $102,858.07 represented income from other sources which was credited to the income account (R. 12, 12A, 19–21, 34–35, 54). During the year 1931, the trust expended $212,862.80, which was charged against the income account. Of this amount, $22,350 represented annuity payments and

$190,000 represented the payments to charities involved in this proceeding. This left a balance of $89,553.99 in the income account at the close of the taxable year (R. 21, 35, 54). There is no dispute that the $190,000 was paid to institutions of the type designated in Section 162 (a) of the Revenue Act of 1928 (R. 21–22).

The book value of the principal of the trust was $1,922,702.51 on January 1, 1931, and $1,989,043.50 on January 1, 1932. The market value of the securities and cash in the principal of the trust on January 2, 1931, was $2,119,835.81, and on December 31, 1931, was $1,488,140.43 (R. 22).

The ages of the nine annuitants still living in 1931 ranged from 54 to 85 years, and the total annuities paid or payable in 1931 amounted to $22,900. The cost of purchasing annuities for all of the annuitants in 1931, if purchased in the first six months of the year from The New York Life Insurance Company, would have been $220,804.33 (R. 23, 54).

The petitioner filed a fiduciary return for 1931 on Form 1041, showing the trust income apportioned to itself and to the annuitants (R. 19, 31–32, 55). It also filed an individual income tax return on Form 1040 for itself, as trustee, in which it reported as gross income the income apportioned to it on the fiduciary return and took a deduction of a like amount "Set aside for Charitable and Educational Purposes." Capital net gains from sales of

trust corpus held more than two years were also reported in the individual return filed by the petitioner and shown as "Set aside for Charitable and Educational Purposes" (R. 19, 32–33, 55).

In auditing the returns filed, the Commissioner of Internal Revenue determined net income to be $164,339.39, consisting of $61,481.32, representing gains from sales of trust corpus, and $102,858.07, income from other sources (R. 10–12, 19, 34–35, 54). He allocated the entire net income and capital net gain to the petitioner, as trustee, allowing no deduction for payments to annuitants or payments to charities, and determined the deficiency in controversy (R. 10–12A).

The Board of Tax Appeals sustained the Commissioner's action in disallowing the deduction for amounts paid to annuitants (R. 55), and that part of its decision was not appealed. The Board further held that any part of the gross income for 1931 which was paid to charities was deductible. However, it determined that the deed did not provide whether income or corpus should be used; and found that the trustees in 1931 really intended to distribute "income" theretofore accumulated; and that the evidence did not show that more than $2,000.57 of the 1931 income had been used in making the payments. Hence, the Board allowed a deduction of that amount (R. 55–59). Both parties appealed to the Circuit Court of Appeals for the First Circuit (R. 62, 71).

The Circuit Court of Appeals with one dissent reversed the Board, holding that no part of the sums paid was deductible, on the ground that Section 162 (a) allows deduction only of those sums paid or permanently set aside at the direction of the grantor, and does not authorize deduction of such sums paid or set aside by the trustee in the exercise of a discretion granted in the instrument (R. 77–84).

SUMMARY OF ARGUMENT

I

The trust deed gave to the petitioner a discretionary authority to make payments to charities and similar organizations. Section 162 (a) of the Revenue Act of 1928 (*infra*, p. 30) does not include such payments in allowing a deduction when made "pursuant to the terms of the will or deed creating the trust." To construe the Act otherwise makes the quoted qualification meaningless and requires that the administrative interpretation, confirmed by repeated reenactments, be ignored. Decisions on this and analogous questions point to a construction requiring the payments to be directed by the will or trust deed if the deduction is to be allowed.

That "pursuant to" often means "as authorized by" does not compel a mechanical application of this particular meaning in an alien context. The Congressional desire to benefit charities would be equally served by a complete omission of the quali-

fication and, in any event, may be supposed to be directed at trustors rather than the trustees. The question of the construction of the statute was properly in issue in the court below.

II

The deduction is limited to "any part of the gross income" which is paid, set aside, or is to be used for the purposes specified. This means the *current* income that would, but for the deduction, be subject to income tax. Thus, even though it be assumed that the statute permits deduction of payments made within the discretion of the trustee, it must be shown that they were made from current income; and the Board's determination that not more than $2,000.57 has been shown to have been so paid must be affirmed.

III

The petitioner's argument that the gross income earned in 1931 constituted sums which were directed by the trustee to be used exclusively for charitable purposes is based upon a misconstruction of the trust deed. The grantor directed its payment to charities only after the death of the survivor of the annuitants. The annuities were a charge upon both the income and the corpus. Thus, distribution of the residue could not occur until after satisfaction of all of the annuities. Cf. *Helvering* v. *Pardee*, 290 U. S. 365, 370. Whatever the

factual likelihood in 1931 that the charities would receive the amounts not paid to the annuitants, the legal fact remains that they had no certain interest in the corpus. This is the distinction drawn by the cases in this Court and in the lower courts.

ARGUMENT

I

THE STATUTE AUTHORIZES DEDUCTION ONLY OF THOSE AMOUNTS PAID, SET ASIDE, OR USED FOR CHARITABLE PURPOSES AT THE DIRECTION OF THE GRANTOR

The Circuit Court of Appeals held (R. 79):

> in order for payments to charitable institutions from the income of any particular year to be deductible, they must be directed by the person creating the trust and not be left to the judgment of the fiduciary. *Bowers* v. *Slocum et al.*, 20 Fed. (2d) 350, 352; *Guaranty Trust Co. of New York, Exr.*, v. *Commissioner*, 31 B. T. A. 19, 22; *Charles P. Moorman Home for Women et al.* v. *United States*, 42 Fed. (2d) 257 * * *.

We submit that this decision is required under the words of the statute, the consistent interpretation in the Treasury Regulations and the decisions of the courts. If, in the face of these authorities, there were any doubt, the general canons of construction of a taxing statute indicate that the decision must be affirmed.

1. Section 162 (a) of the Revenue Act of 1928 (*infra*, p. 30) allows a trustee to deduct from its

taxable income the amount which, "pursuant to the terms of the will or deed creating the trust", is during the taxable year paid or permanently set aside for charitable and other contributions.

The quoted qualification must be taken to have some meaning. Petitioner contends that it refers only to the requirement that the payments or disposition be authorized and would have this Court read it merely to mean that the trustee will be allowed no deduction for unauthorized contributions to charity. But Congress could hardly have been concerned with imposing tax sanctions in addition to the rigorous penalties afforded by a court of equity against breach of fiduciary duty. It must have designed its tax statutes to meet the ordinary situations, and not to impose on the estate an irrelevant denial of tax deductions merely because its trustee stepped beyond his authority. Under petitioner's construction the qualification to the allowed deduction would rarely, if ever, be operative. It would have no relation either to revenue collections or the encouragement of charitable institutions; had the limitation been omitted entirely one supposes that both charitable contributions and tax deductions would be in precisely the same volume as if petitioner's construction were adopted. If, therefore, the requirement that the contributions must be "pursuant to the terms of the will or deed creating the trust" is to have any reasonable meaning, it must mean that the trustee

must show something more than mere authority if he is to secure a deduction.[1]

This conclusion is reinforced by the contrasting language of subsection (c) of the same Section 162 (*infra*, p. 31). When dealing with payments to beneficiaries out of income which the trustee was authorized either to accumulate or distribute, the statute describes this authority as "in the discretion of the fiduciary." Had a similar latitude been intended in subdivision (a), Congress would assuredly have used the more precise term "in the discretion of the fiduciary" which is found in subdivision (c). Since "pursuant to" the will or trust deed must thus mean something more than a discretionary power, or non-mandatory authorization, it can mean only a mandatory direction.

2. Treasury Regulations 74, applicable here, provides in Article 862 (1) (*infra*, p. 31) that the deduction will be allowed "if the terms of the will or of the deed creating the trust *direct* that any part of the gross income of the estate or trust * * * be paid or permanently set aside for charitable or other purposes * * *." Petitioner apparently does not argue that deduction of the sums here in controversy is authorized under

[1] The committee reports throw no light on the proper interpretation of this provision. See Sen. Rep. No. 617, H. Rep. No. 1037 (p. 52), 65th Cong., 3d Sess.; H. Rep. No. 179 (p. 21), S. Rep. No. 398 (p. 25), H. Rep. No. 844 (p. 19), 68th Cong., 1st Sess.

this Regulation, and it seems plainly to be forbidden by its terms.

Article 862 (1) is identical with Article 342 (1) of Regulations 65 and 69, promulgated under the 1924 and 1926 Acts, and with Article 862 (1) of Regulations 77, promulgated under the 1932 Act.[2] So far as the present question is concerned, a similar interpretation was made under the Revenue Acts of 1918 and 1921.[3] Throughout this long history of administrative interpretation there have been repeated reenactments of the statutory provision without relevant change.[4] This failure to

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[2] Article 162–1 (1) of Regulations 86 and 94, promulgated under the 1934 and 1936 Acts constitute a rewritten version of the interpretation of Section 162. In the rewriting the word "directed" was omitted and the statute paraphrased as "by the terms of the will or of the instrument creating the trust." Whatever ambiguity the statute contains is thus duplicated in the Regulations after 1934. The earlier interpretation is, of course, not revoked but merely expressed in terms of the statute.

[3] Section 219 of the Revenue Acts of 1918 (c. 18, 40 Stat. 1057) and 1921 (c. 136, 42 Stat. 227) contained a similar qualification that the charitable contributions could be deducted only if made "pursuant to" the will or trust deed. This was interpreted in Article 342 of Regulations 45 and 62 to result in the tax being imposed if the trustee had discretion to accumulate or distribute, even though distributed to a tax-exempt beneficiary.

[4] The provision in its present form first appeared as Section 219, 1924 Act, c. 234, 43 Stat. 253; it was reenacted in Section 219, 1926 Act, c. 27, 44 Stat. 9; Section 162, 1928 Act, c. 852, 45 Stat. 791; Section 162, 1932 Act, c. 209, 47 Stat. 169; Section 162, 1934 Act, c. 277, 48 Stat. 680; Section 162, 1936 Act, c 690, 49 Stat. 1648.

change the section imports Congressional approval of the regulation, *Brewster* v. *Gage*, 280 U. S. 327, 337; *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492; *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299, 307, sufficient to give it the force of law, *Old Mission Co.* v. *Helvering*, 293 U. S. 289, 294; *Hartley* v. *Commissioner*, 295 U. S. 216, 220.

3. This Court has never considered the question now presented. But the decisions of the lower Federal courts leave small doubt as to the proper interpretation of the limitation upon the trustee's privilege to deduct charitable contributions.

The fullest discussion is found in *Charles P. Moorman Home for Women* v. *United States*, 42 F. (2d) 257 (W. D. Ky.), which involved the corresponding provision of the Revenue Acts of 1918, 1921, and 1924. The court's reasoning is typified by the following extract (pp. 260–261):

> The quoted language of section 219 of the act of 1918 makes it clear that the trust income, to be exempt from taxation as a charitable contribution, must be paid to or permanently set aside during the taxable year for a corporation organized and operated exclusively for charitable purposes, and that such payment or permanent setting aside must be pursuant to the terms of the instrument creating the trust. In other words, the instrument creating the trust must make it clear that it was the intention of the creator of the trust that such income should be paid

> during the taxable year to the charitable corporation or permanently set aside to it during such taxable year. The statute makes it very clear that it was not the intention of Congress to make the taxability of the income for any taxable year depend upon the discretion of the trustee in paying or permanently setting aside the income of the trust to the charitable purpose during the taxable year, but to depend solely upon the provisions of the instrument creating the trust.

In *Bowers* v. *Slocum*, 20 F. (2d) 350, 352 (C. C. A. 2d), the court said that the corresponding provision of the 1918 Act "does not make the deduction depend upon the action of the executors in crediting the income upon their books, but upon the permanent setting aside of the income by the will itself for corporations of the character in question."

In *Boston Safe Deposit & T. Co.* v. *Commissioner*, 66 F. (2d) 179 (C. C. A. 1st), certiorari denied, 290 U. S. 700, which arose under the Revenue Act of 1926, the court said (p. 183):

> The answers to the questions involved depend on whether the testator intended *by the terms of his will* that * * * any part of the income thereof can be considered as set aside permanently, for the purposes and in the manner specified in section 214 (a) (10) * * *. [Italics added.]

This construction of Section 162 (a) and the corresponding provision of other revenue acts seems to have been uniformly applied by the courts and the Board of Tax Appeals. *Clark* v. *Commissioner*, 8 B. T. A. 197; *Estate of W. S. Tyler* v. *Commissioner*, 9 B. T. A. 255; *Bank of America National Association* v. *Commissioner*, 19 B. T. A. 1273. See also *Welch* v. *Commissioner*, 9 B. T. A. 1370; *McClung* v. *Commissioner*, 13 B. T. A. 335; cf. *Lederer* v. *Stockton*, 260 U. S. 3.

The construction of Section 162 (a) adopted by the court below is in harmony with the construction placed upon other provisions of the taxing statutes having a similar purpose. Section 162 (b) of the 1928 Act (*infra*, p. 30) and the corresponding section of other revenue acts provide an additional deduction for the amount of trust income "which is to be distributed currently by the fiduciary to the beneficiaries." It has been held that unless the trust instrument unqualifiedly requires the distribution, the deduction is not allowable. *State Sav. Loan & Trust Co.* v. *Commissioner*, 63 F. (2d) 482 (C. C. A. 7th); *Roebling* v. *Commissioner*, 78 F. (2d) 444 (C. C. A. 3d).

The decisions of this Court in *Helvering* v. *Pardee*, 290 U. S. 365, 370–371 (decided with *Helvering* v. *Butterworth*, 290 U. S. 365), and *Burnet* v. *Whitehouse*, 283 U. S. 148, are based on this same principle. In the *Pardee* case the decedent had left the residue of his estate in trust and pro-

vided for the payment of an annuity of $50,000 to his wife. During the years considered the trustees had paid the annuity from income of the trust and claimed a deduction of the full amount as income "to be distributed currently by the fiduciary to the beneficiaries" within the meaning of Section 219 (b) (2) of the Revenue Act of 1926. In disallowing the deduction, this Court, following its decision in *Burnet* v. *Whitehouse, supra,* held that the annuity payments did not depend upon income of the trust estate, that they were payable without regard to the income derived by the trust estate, and that they were not distributions of income but payments in discharge of a gift or legacy. In the *Whitehouse* case, which involved the converse situation, the Court had already held that annuity payments were not taxable to the annuitant, although made from current income of the trust. In each case the emphasis was placed on the direction of the instrument creating the trust that the annuity should be payable in all events instead of providing that payment should only be made from income.

The same principle is applied in determining the right to deductions from gross estate, for purposes of computing the Federal estate tax, for gifts or bequests to charities. Such deductions are allowable only when definitely provided for by the testator in his will. *Mississippi Valley Trust Co.* v. *Commissioner,* 72 F. (2d) 197 (C. C. A. 8th), certiorari denied, 293 U. S. 604, 631; *Glaser* v. *Commis-*

sioner, 27 B. T. A. 313, affirmed on another issue, 69 F. (2d) 254 (C. C. A. 8th), certiorari denied, 292 U. S. 654; *Burger* v. *Commissioner*, 12 B. T. A. 1391.

4. Petitioner argues that Section 162 (a) should be construed in the light of the Congressional purpose to encourage charitable contributions. *Lederer* v. *Stockton*, 260 U. S. 3. We do not deny this purpose. We do doubt that it would be furthered by the construction petitioner urges.

It has earlier been pointed out (*supra*, p. 10) that this suggested purpose is not furthered by the inclusion of the words "pursuant to the terms of the will or deed creating the trust" if petitioner's construction is taken, since on that construction the words are virtually surplusage. More than that, however, it is reasonable to believe that the Government's construction of the phrase is likely to result in the application of larger amounts to charitable purposes. By directing the inducement to the trustor rather than to the trustee, Congress has furnished a strong incentive for the making of indefeasible gifts to charity by trustors, not subject to application by trustees to noncharitable purposes.

And while the beneficent purpose of Congress in dealing with charitable, religious, and educational institutions is well recognized, it is nevertheless true that a deduction for payments to such institutions, like other deductions from gross income, can only be allowed when clearly authorized by law.

Cf. *Sun-Herald Corp.* v. *Duggan*, 73 F. (2d) 298, 300 (C. C. A. 2d); *Guaranty Trust Co. of New York* v. *Commissioner*, 31 B. T. A. 19, 22, affirmed, *per curiam*, 76 F. (2d) 1010 (C. C. A. 2d); *Potter* v. *Bowers*, 15 F. Supp. 724 (S. D. N. Y.), pending on appeal to the Circuit Court of Appeals for the Second Circuit. And statutes authorizing such exemption are construed strictly in favor of the Government. Cf. *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232; *Pacific Co.* v. *Johnson*, 285 U. S. 480.

5. The petitioner argues that the words "pursuant to" should be wrenched from their setting and given a lexicographer's definition based upon uses in wholly dissimilar situations. We see little to be gained if we were to follow the petitioner in its cataloging of the senses in which "pursuant to" has been used. We readily concede that it often means no more than "authorized in discretion to." It seems equally plain that in other contexts it means "acting under the direction of." A word is not a building block, of the same shape and serving the same purpose wherever placed, but as Mr. Justice Holmes, in *Towne* v. *Eisner*, 245 U. S. 418, 425, has said, "it is the skin of a living thought" whose content changes with its context. We submit that, as used in Section 162 (a), the phrase "pursuant to the terms of the will or deed creating the trust" can have a reasonable meaning, consistent with the Revenue Acts and their administrative interpretation, only if construed in its equally natural sense to mean as *directed* by the will or trust deed.

6. There remains only petitioner's suggestion (Br. 14–15) that the court below could not have decided the case on this ground if it was not raised in the Board of Tax Appeals or specifically assigned as error in the court below.[5] Petitioner relies on *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200. This case has no bearing here. It grew out of a situation where a Circuit Court of Appeals reversed the Board of Tax Appeals on a ground not suggested before the Board and which turned on a question of fact which might have been developed in a different manner had the question been raised before the Board. Here the ground upon which the court below placed its decision was one purely of law—the construction of the statute. Nothing in the *General Utilities* case indicates an intention to overrule the settled doctrine that the appellate court has power to consider any question presented by the record. *Friend* v. *Talcot*, 228 U. S. 27, 36; *Wuchter* v. *Pizzutti*, 276 U. S. 13; *Cole* v. *Ralph*, 252 U. S. 286; *Chase, Jr.* v. *United States*, 256 U. S. 1. It is plain that there is no abuse of power in refusing to apply a statute without inquiry as to its meaning, even though the lower

[5] No new issue was raised in the Circuit Court of Appeals. The regulation construing section 162 (a) (Art. 862 (1) *infra*, p. 31) specifically provides that deduction will be allowed of that part of the gross income *directed* by the terms of the instrument to be paid or permanently set aside. The Commissioner disallowed the deduction on authority of *Boston Safe Dep. & Tr. Co.* v. *Commissioner*, *supra* (R. 11–12). This issue was necessarily raised before the Board (R. 3).

court did not pass on the question. In *Helvering* v. *Gregory*, 293 U. S. 465, this Court affirmed the Circuit Court of Appeals in deciding a tax controversy on a construction of the statute which was not urged in the Board of Tax Appeals.

II

EVEN IF THE STATUTE PERMITS DEDUCTION OF ALL PAYMENTS AUTHORIZED, PETITIONER HAS FAILED TO ESTABLISH THAT THEY WERE FROM GROSS INCOME OF 1931

The burden is upon the petitioner to establish its right to any deduction from gross income. Cf. *Burnet* v. *Houston*, 283 U. S. 223; *Burnet* v. *Thompson Oil & G. Co.*, 283 U. S. 301; *Woolford Realty Co.* v. *Rose*, 286 U. S. 319; *New Colonial Co.* v. *Helvering*, 292 U. S. 435.

Section 162 deals with the income earned by the trust during the taxable year. The increase or decrease of the principal is immaterial in this regard. Therefore in allowing a deduction of a part of "the gross income" the Act must refer to the gross income of the taxable year. It hardly could have been intended that payments out of corpus, or out of income accumulated during prior years, should be allowed as a deduction from this income. There is in this regard no difference whatever between the original corpus and the accumulated income; neither has relation to the income received during the taxable year.

The deed (R. 29) authorized the trustee to pay to charities "such sums as in their judgment may

be paid without jeopardizing the annuities * * * whenever for a period of one year the trust fund held by them as then invested *shall have* yielded a net income equal to twice the amount of the annuities * * *." The stipulation of facts shows that "the taxpayer considered that it had power to pay to charities defined in the trust instrument such parts of the *principal and income* of the trust" as would not jeopardize the annuities (R. 20). It seems very questionable whether the trustee was authorized to make payments from *current* income, since the measure of its authority was the income of past years. At any rate, payments were not limited to current income, and petitioner has not shown that all of the payments involved were made from current income. Obviously this could not have been the case, for payments aggregating $190,000 were made to charities during the year, while the gross income, including capital gains, amounted to only $175,319.18 (R. 54). The Board found (R. 57–58):

> The facts as stipulated show that the trustees, in making their appropriations, did not have in mind the income of the current taxable year. They considered only the income available on June 2, 1931. That consisted principally of the accumulated income of a prior year. The accumulated income at the beginning of the year amounted to $187,999.43. They made appropriations of $180,000. They paid in 1931, $160,000 of the amount thus appropriated and $30,000

> appropriated in 1929. These facts rather indicate that the trustees in 1931 really intended to distribute income theretofore accumulated rather than to distribute the current income of 1931. * * *
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> * * * * * *
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> * * * petitioner has not shown that more than $2,000.57 of the $190,000 was paid from gross income of 1931 * * *. Lynchburg Trust & Savings Bank et al., Trustees, 27 B. T. A. 1182. (reversed on other grounds, 68 F. (2d) 356).

This finding is not based, as petitioner would have it, upon the accident of the book entries of the trustee. It is found in the real distinction between current income, for income tax purposes, and the accumulated income which a trustee must often keep separate from the corpus. An analysis of petitioner's contention that it need only show payments from its income account discloses its unreasonable character. For, if it may deduct payments of "accumulated income" of prior years, it may thus secure a deduction which exceeds the gross income for the year. And a trustee could thus hold current income for individual beneficiaries and pay no tax thereon. In the instant case the $20,000 paid to annuities would go untaxed.

We submit it is clear that only payments to charities out of current income are deductible, and that petitioner has not shown that more than $2,000.57 of the payments in question, as the Board found, were made from that source.

III

RECEIPTS OF THE TRUST FOR 1931 (ABOVE THE AMOUNTS REQUIRED TO PAY ANNUITIES AND EXPENSES) DID NOT CONSTITUTE INCOME PERMANENTLY SET ASIDE OR TO BE "USED EXCLUSIVELY FOR CHARITABLE PURPOSES"

The petitioner argues (Br. 28–40) that if the $190,000 is not deductible as income "paid" pursuant to the terms of the deed creating the trust, then the gross income of the trust for 1931, in excess of the amounts required for annuity payments should be deducted as income "which pursuant to the terms of the will or deed creating the trust * * * is to be used exclusively for" the purposes designated in Section 162 (a) (*infra*, p. 30). The argument assumes a deduction is to be allowed only if the trust deed directed, rather than merely authorized, the exclusive use for charitable purposes (see Point I, *supra*) and asserts the proposition that the trust deed did direct this use of the trust funds. The contention is based upon the assumption that the income, as it was received by the trustee, was devoted to charitable purposes, subject only to a condition subsequent that the annuities be paid (Br. 29).

This basic postulate of the petitioner is unfounded. The payments to charities and similar organizations could take place only under paragraph 13 of the trust deed (R. 29). This gives the trustee, first, a discretionary power to make payments when the previous year's income has equalled twice the amount of annuities. Clearly

this provision does not constitute a direction that the income be devoted exclusively to charitable purposes. The second provision is:

> * * * upon the death of the survivor of those persons, who under the terms of this instrument are to receive annual incomes under the trust hereby created, I direct my said trustees to distribute the rest and residue remaining in their hands among corporations and trustees organized, operating and holding exclusively for religious, charitable, scientific, literary or educational purposes * * *.

It seems plain that, until the last of the annuitants has died, no sums have been set aside exclusively for charitable purposes. Whatever the actuarial and financial probability that the annuities will represent an inconsiderable claim on the trust estate, the fact remains that the will directs distribution to charities only after the annuities have been satisfied in full. This is not a present grant, subject only to life estates in the annuitants. By the terms of the trust deed the entire trust estate, income and principal alike, is devoted to the satisfaction of their claims. *Helvering* v. *Pardee*, 290 U. S. 365, 370; *Burnet* v. *Whitehouse*, 283 U. S. 148. Thus it cannot be said that any portion of the funds so held is "permanently set aside" or "to be used" *exclusively* for charitable purposes. Such were the holdings both of the Board (R. 56) and of the court below (R. 82).

The possibility, which had become a reality by 1931, that annuity requirements would decrease to

the point where there would be little reason to believe that any payment would ever have to be made from corpus, was taken care of by the provisions under which payments were made to charities during the year involved. These payments, however, were discretionary with the trustee and were essentially advance distributions of corpus. There is nothing in the trust instrument which can be construed as permanently setting aside any part of the excess income or capital gains prior to distribution.

The cases of *Hartford-Connecticut Trust Co.* v. *Eaton*, 36 F. (2d) 710 (C. C. A. 2d) and *Ithaca Trust Co.* v. *United States*, 279 U. S. 151, relied upon by the petitioner (Br. 29–32), do not require a contrary conclusion. The *Ithaca Trust Company* case considered the estate tax imposed under the Revenue Act of 1918 where the testator gave the residue of his estate to his wife for life with authority to use from the principal any sum "that may be necessary to suitably maintain her in as much comfort as she now enjoys." The remainder was to go to charities. The question was whether the value of this residue was deductible from the gross estate as a bequest to charities. It was held that the income of the estate was sufficient for this purpose, and that therefore this provision did not render the gifts to charities sufficiently uncertain to defeat the deduction. The *Hartford-Connecticut Trust Co.* case involved income taxes upon an estate held in trust, the income to be paid to the widow for life, with the remainder over to certain

charities. The will further authorized the trustee to pay over to the widow any part of the principal fund "which it may deem necessary or advisable for her comfortable maintenance and support." During the taxable year the trustee realized a gain from the sale of trust property, which under the terms of the will represented trust corpus distributable to charities. The court held that, since the income would always be sufficient for the widow's support, the gain from sales of corpus was permanently set aside for charitable purposes. In each of these cases the payments to the life beneficiaries required under the terms of the will were not a charge upon the corpus and the remainder might properly be said to be permanently set aside for the charities.

In *Boston Safe Deposit & Trust Co.* v. *Commissioner*, 66 F. (2d) 179 (C. C. A. 1st), certiorari denied, 290 U. S. 700, where the decedent's will provided for the payment of certain annuities which were ~~also~~ a charge upon the whole fund, the present principle was applied both to excess income and to gains from sales of corpus.[6] The court said (p. 184):

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[6] In *Hartford-Connecticut Trust Co.* v. *Eaton*, 41 F. (2d) 69 (D. Conn.), also relied upon by the petitioner (Br. 29), the testator's will provided for the payment of one annuity of $5,000, "and the entire income, *subject to the payment of said annuity*, to his wife" and after her death the trust fund to be held as a perpetual fund for charitable purposes. Here, again, there does not appear to have been a definite charge, even of this small amount, upon the entire fund.

It cannot be said, we think, and the testator was evidently of the same opinion, that there was no possibility that in periods of depression, such as occurred in 1929–33, it might not be necessary to use a part of the principal, together with any accumulated income, to meet all the fixed amounts to be paid "pursuant to the terms of the will."

CONCLUSION

For the reasons which have been set forth, we respectfully submit that the decision of the Circuit Court of Appeals is correct and should be affirmed.

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APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791, 801, 838:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(n) *Charitable and other contributions.*— In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

(1) the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(3) the special fund for vocational rehabilitation authorized by section 7 of the Vocational Rehabilitation Act;

(4) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(5) a fraternal society, order, or association, operating under the lodge system, but

only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals; to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary. (For unlimited deduction if contributions and gifts exceed 90 per centum of the net income, see section 120.)

SEC. 161. IMPOSITION OF TAX.

(a) *Application of tax.*—The taxes imposed by this title upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) *Computation and payment.*—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the

fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor). For return made by beneficiary, see section 143.

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (n)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (n), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance, or operation of a public cemetery not operated for profit;

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as

a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 862. *Method of computation of net income and tax.*—The Act provides that the tax computed upon the net income of the estate or trust shall be paid by the fiduciary, except as provided in sections 166 and 167. (See article 881.) However, in computing the net income of the estate or trust, the following deductions will be allowed either in addition to, or in lieu of (as the case may be), those specified in sections 23, 119, 213, and 251 in the case of individuals:

(1) If the terms of the will or of the deed creating the trust direct that any part of the gross income of the estate or trust (a) be paid or permanently set aside for charitable or other purposes, as specified in section 23 (n), or (b) be used exclusively for religious, charitable, scientific, literary, or edu-

cational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance, or operation of a public cemetery not operated for profit, such gross income so paid or set aside during the taxable year shall be allowed as a deduction in lieu of the deduction authorized by section 23 (n).

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